

September 22, 1967 Letter 370

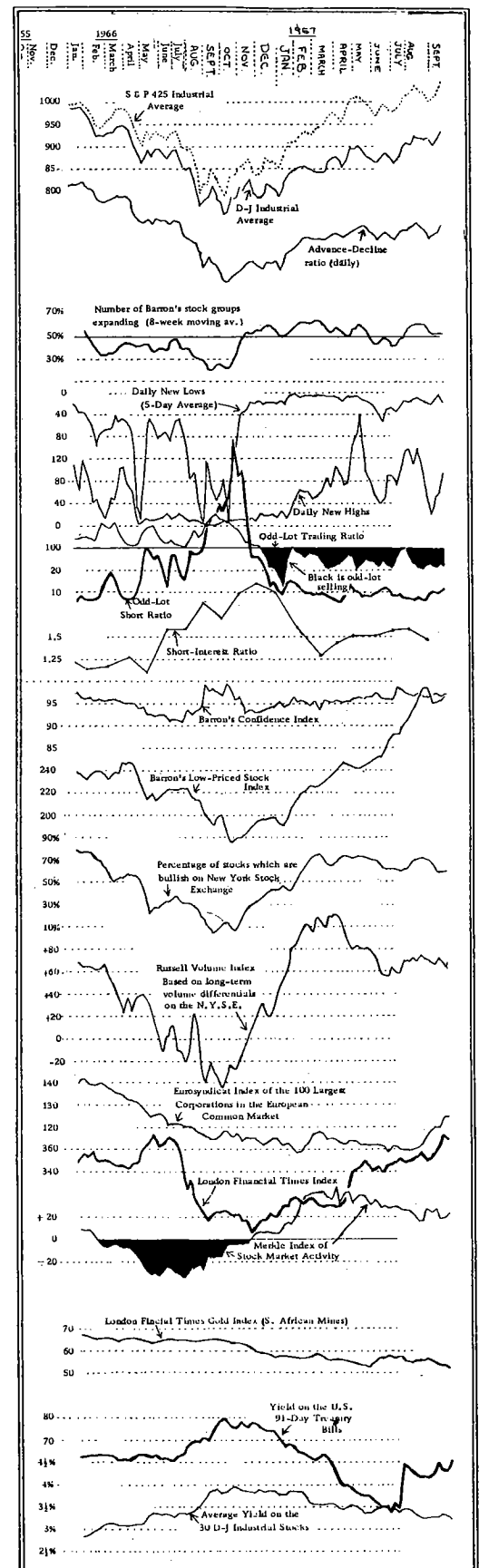
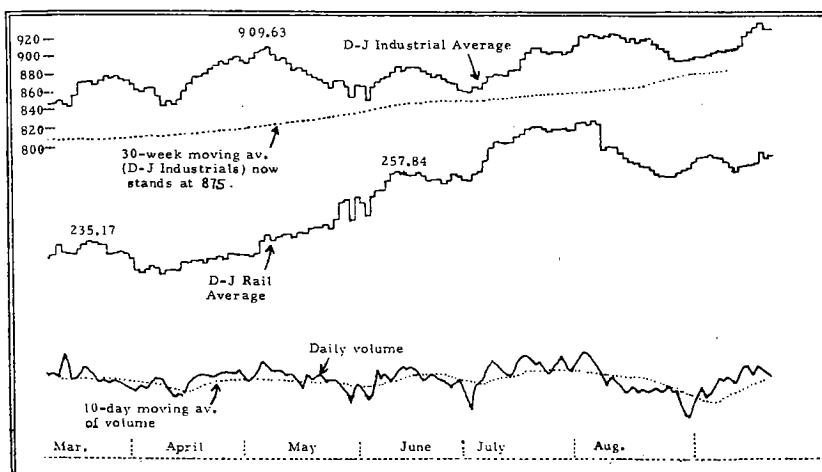
OMENS: In the issue of September 4, Paul Dysart wrote of the major bear signal he received on his negative volume index. I have been following Dysart's Trendway service for years, and it is well to note that four out of five of his "signals" have been valid. His negative volume index is constructed by tabulating the advance-decline differentials on days when volume is below that of the preceding day. The resulting index is charted and when the negative volume index zig-zags below a previous important low, a bear signal is rendered. Dysart's important August bear signal is in effect as of now.

Joseph Granville received a bearish signal two weeks ago when his "on-balance-volume" for the D-J Industrials cracked to a new low. Granville computes his OBV by charting the volume in the 30 Dow Industrials stocks, adding this volume on days when the Dow is up, subtracting when the Dow is down. Bear signals are given when the OBV zig-zags below a preceding low point.

The Russell long-term Volume Index (page 1) turned weak (see last Letter) on September 8 when the Index broke to its lowest level since early June. Such weakness, in the past, has preceded weakness in the market within a matter of weeks.

All three of these signals are based on either volume or the advance-decline line and volume. So it is breadth and volume which is now "running out of steam" during this great bear market rally of 1966-67.

THE MARKET: On September 13 the Wall Street Journal reported, "The President's standing with the voters portends severe trouble for the major tax and domestic spending legislation Mr. Johnson is trying to push through Congress. Visible support for the proposed 10% income-tax surcharge on corporations and individuals has all but vanished." At the Congressional hearings for the surtax, Roy Reiersen, chief economist of Bankers Trust Co. of N. Y. also issued a warning, "The U.S. faces a fiscal emergency which is far more serious than is generally recognized and which presents a grave threat to the economy as a whole." Reiersen went on to explain that the threat is posed by the coming huge Federal budget deficit,



On the other hand, House Ways and Means Committee Chairman Mills stated that the Administration had not made a convincing case for a tax rise. Furthermore, he warned, even if a tax rise was voted it would be a permanent feature of the economy, not a temporary emergency measure. Instead of a tax cut, argued Mills (and many wondered if he was serious), the Administration should cut spending by \$7.5 billion.

In the face of this fiscal pussyfooting, the bond market continued to sink to "safer" levels, with most Treasury debt issues at or near their historic lows. On September 19 the broadly representative D-J 40-Bond Average (now yielding better than 6%) broke to another low for the past 33 years. On the same day the bellwethers of the short-term money market, the 91-day Treasury bills, pushed to a new yield high for 1967 at 4.57%. This was well above their August peak of 4.50%. Finally, on September 19 the 4½'s of 1987-92, the bellwethers of the long-term Treasury market fell to 86.28, their lowest level since issuance in 1962. At this price they yielded a whopping 5.16%.

Down on Wall Street the Averages were also tracing a rather interesting price structure. On August 4 the D-J Rail Average reached an historic high of 276.24. A few days later, on August 9, the Industrial Average pushed to a 1966-67 recovery high of 926.72. Following this a mild decline occurred. On the ensuing rally, Industrials advanced strongly while Rails joined in a rather half-hearted manner (see page 1 chart).

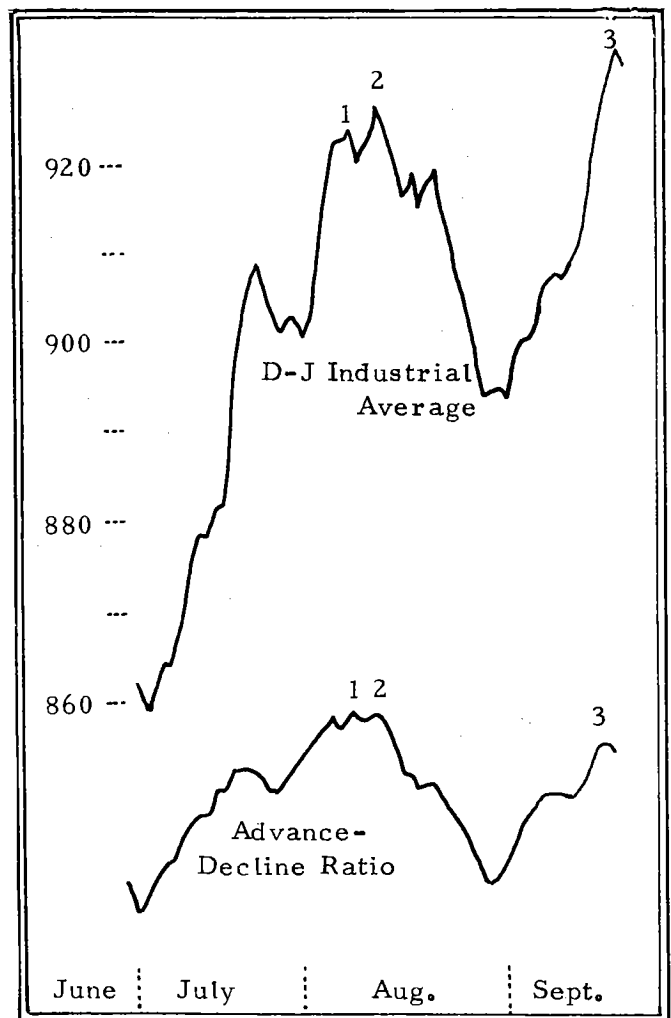
August 14 saw the Industrials hurdle their earlier high, to close at a new recovery high for the entire 1966-67 move. Rails, however, remained laggard, and as of this writing the Rail Average has failed to confirm by bettering its 276.24 peak. This is the first time during the rally from the October, 1966 lows, that the carriers have refused to lead or at least confirm a new recovery peak in the Industrial Average. For this reason, I suggest that all eyes be directed to the forthcoming ability (or inability) of Rails to match the action of the senior Average. A persistent refusal by Rails to better 276.24 could spell trouble ahead.

Potentially just as significant (see last Letter), is the series of non-confirmations in the advance-decline ratio. Note on the accompanying chart the points 1 and 2 of early August. At point 2, the A-D ratio failed to confirm the new high in the Industrial Average. Weakness followed, and a three-week decline took place. On the most recent rally the Industrials surged to a new high, well above the previous peak at point 2, but the A-D ratio turned sluggish. As of this writing a series of two non-confirmations exist between the A-D ratio and the Industrial Average (at points 2 and 3). Historically, this type of relationship between price and breadth has preceded many important declines. It will therefore be most important to note whether, in the period ahead, the A-D ratio is able to confirm the Dow by bettering its preceding peak at point 1 on the chart.

INTEREST RATES AND TAXES: Some of the nation's leading money experts are becoming queasy. Writing in the Weekly Bond Buyer (Sept. 11), world monetary authority Sidney Homer of Salomon Brothers & Hutzler warns of the danger of defeating the President's proposed surtax. In a long article, Homer documents the many failures of various nations in the past to handle their money and debts correctly. Homer states that if the "New Economics" fails to support the surtax at this crisis, "Mr. Rueff, de Gaulle's economist, will be able to claim that he was right when he said that no Democracy can manage its own fiscal affairs successfully."

Mr. Homer makes a number of rather strict assumptions. He then states: "I will spare you the details of the financial chamber of horrors....(if the surtax is not enacted) Corporate bonds yields could well reach 7% treasury bill yields could reach 6%.... This is not a forecast; we live in too enlightened an age to permit such a calamity. But this is a genuine threat if we substitute words and hopes and compromises for adequate fiscal action."

Later Homer notes: "The bond market has recently told us in unmistakable terms that if an out-sized Treasury deficit is superimposed on existing heavy private credit demands, the market will again have to ration credit by means of a money crunch. This would probably be more severe than that of 1966 when the Treasury had no deficit. And savings institutions, if no counter measure



were taken, will again be the first victims. The revival in home construction will die on the vine."

Meanwhile, the surtax is running into rough sledding in Congress, and House Ways and Means Committee Chairman Wilbur Mills is balking. He feels that LBJ is ducking out, leaving him (Mills) with the onerous task of attempting to shove the bill through the house. In effect, Mills is now saying, "Start selling the tax boost to the American public, Mr. Johnson, or Congress will kill it!" With the election coming up next year, there is a question of whether LBJ has the nerve to try to sell his surtax to a public which has turned stone cold on the Chief Executive.

A final consideration is that bond yields are extremely high in the face of the current fantastically easy Federal Reserve monetary policy. This means that yields could go considerably higher if the Fed decides to tighten the money supply. In view of this, I found this paragraph from Anthony Gaubis' latest Business and Investment

Timing report (Sept. 18) to be most interesting: "I am personally of the opinion that the Fed will start to tighten credit if Congress does not go along with the Administration's request for a substantial increase in both corporate and personal tax rates. The Chairman of the F.R.B. has definitely warned that this should be expected, and even went so far as to state that the trend of interest rates might continue upward even if taxes are increased. A number of potential foreign developments could also have a bearing on the monetary outlook."

MORE ON GOLD: I have been reading a good deal about the now famous Conference of the Group of Ten. This was the conference which adopted the "Special Drawing Rights" or SDR's via the International Monetary Fund. The gold shares sold off sharply on the "sensational" news of the Conference, news which was played up as a "major victory" by sundry administration spokesmen.

But the more I study the Conference's proposals, the less impressed I am with the potentialities. First, the proposals amounted to a stinging defeat for the U.S. because the U.S. agreed to the stipulation that it would require 85% of the IMF vote to effect the SDR's, the U.S. gave up a major part of its international fiscal power. The Common Market Nations possess almost 20% of the IMF vote, and they have a huge stake in gold. They are not likely to let the U.S. crank the international printing presses. They can hardly afford it with their important position in gold.

Secondly, despite talk and gossip, no "paper money" was created. The SDR's are tied to gold, and the SDR's actually amount to an extension of drawing rights on the IMF's gold position. The increased drawings will amount to a 1% to 2%

WORDS OF WISDOM DEPT.: This from the Sept. bulletin of old-timer, Ray W. Snyder (investment advisor) of Wichita, Kansas: "The New York Stock Exchange publishes an advertisement and in it I read, '-Less than 1% of the U.S. Corporations make 70% of the profits'. Who buys the 1% and who buys the other 99%? The Stock Exchange also deals in bonds, all kinds, and I prefer bonds, by far, now. I recall in about 1920 of a man writing in the POST of his experience with stocks and he said something like this, — I tried common stocks but I never could make anything, — then I hit on buying only preferred stocks, at a discount, and he added, — 'I have been eating chicken ever since.' Styles change and there are not many preferred stocks anymore (more the pity) but there are bonds at a discount, all kinds, shapes and sizes (even U.S. Bonds). I also recall in 1920 when U.S. 4½% bonds went down to 83, and then quickly came back to par and stayed there until retired. Here we go again and U.S. Bonds may be had around 83 to yield better than 5% and again they will come back to par, — and don't you forget it. If you want to invest today buy U.S. coupon bonds, or registered as you choose."

From the September 15 issue of Paul Dysart's Trendway service: "The process of hedging assumes that at some future time the 'hedge' will be lifted when the episode or event being hedged against ends or disappears. Thus, stocks today have more than paced the rate of currency dilution, and the person who holds them has come out ahead. But remember, we said above that the hedging process envisions an — 'end to the condition being hedged against.' People who buy stocks today pay a terrific premium over those who have 'stayed hedged' all the time. And, in our opinion, an end to the episode being 'hedged against' is now in sight. It will end when: 1) A stable dollar is established, or 2) When the dollar's ties to gold have been severed. Both are discernible by 1) the Rio Conference, and 2) Abolishing the 25% gold backing for Federal Reserve 'money,' as will be recommended by the Treasury. If you envision complete destruction of the dollar, nothing that you may do to 'hedge' against such a catastrophe is likely to endure more than a moment."

From "Contrarian" Humphrey Neill's September 13 Letter: "Behind the expectancy for 'a pronounced upturn' in business is the currently popular, so-called new-economic theory of government spending. (Not very new, as it has been around for sometime!) Yet, not many months ago we read little but about the coming recession. This writer relied upon Viet-Nam and related spending to thwart a recession, but with all the other complications now present, it is asking too much, it seems to me, to expect government spending to give us a new boom unless business-and-consumer spending rises substantially also. An inflation without rising profits (from costs going up, without demand keeping pace) does not spell boom to me — it spells boomerang, more likely."

At any rate, the Conference will convene in Rio on September 25, and at that time the world will get its first glimpse at the machinations behind the SDR's. The hand the Common Market countries will play will be crucial and will set the stage for all future "progress" in international monetary reform.

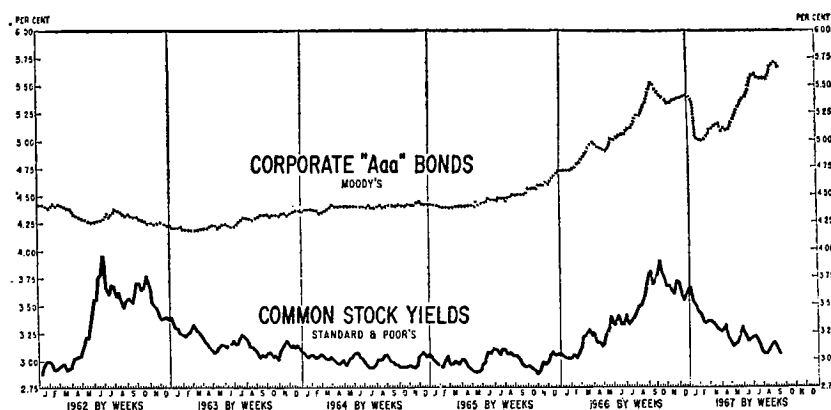
According to David Deitch (syndicated columnist) "....the new plan is basically a stall. It takes some of the edge off American and British balance of payments deficits and at least temporarily reduces the inclination to hoard gold. More important, the agreement forestalls the possibility of world monetary chaos."

Economist Alan Greenspan (head of Townsend-Greenspan) states: "The United States has covered up its B.O.P. deficit statistically as far as it can. Now it is saying that a plan is necessary to subsidize the deficit, or the world will suffer a monetary disaster. The U.S. has in effect told the Europeans, 'We dare you to knock us over.' "

My good friend Harry Schultz writes: "let the cold verdict of the market place render judgment. On the eve of the Big 10 London talks, the pound was at a recent year's low. On the news of the SDR credit agreement the pound rose sharply, gold shares fell like bricks and the price of bullion dropped. But now, some 10 days later, the pound has gone back to where it was and lower (it wasn't free money after all), and gold shares are in most cases rallying back nicely and the gold bullion price is nearly back to its former high— pushing at the limits of the London gold pool. So the people that count weren't fooled and in time even those who don't understand what happened will come to realize that the law of supply and demand has not been repealed, nor has any other economic tenet."

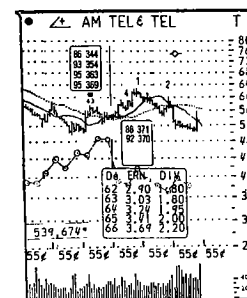
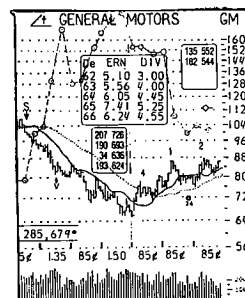
From the Bolton-Tremblay Bank Credit service: "This (pertaining to Special Drawing Rights) is hardly a major change from the existing method of periodically increasing quotas (50% in 1959 and 25% last year). In return for this 'advance to the welfare of all Americans', the U.S. turned over veto power in the IMF to the EEC countries. The deal somehow doesn't seem to justify the jubilation. The only countries with persistent balance of payments deficits, the U.S. and the UK would hardly benefit anyway. Their equity positions in the IMF are too low. For that matter, the U.S. has still to pay up the last quota increase. Small wonder that France raised no serious objection to this watered down scheme needed so badly for the Rio meeting."

CHART OF THE WEEK: With the Standard & Poor 500 stock average yielding 3.06% and Moody's Aaa rated bonds yielding a whopping 5.65%, the negative spread between these two indices rose to the highest adverse level in history (see chart). The spread was 2.59% in favor of high-grade bonds. Obviously, stock buyers were paying little or no attention to the tremendous yield advantage of the best-grade bonds. To put it another way, the average dividends on the S & P stock index would practically have to double in order for stockholders to enjoy the rate of return provided by Aaa bonds. This, to put it mildly, is a commentary on the sanity (or insanity) of today's stock market.



STOCKS: General Motors is probably the most important single stock listed on any exchange in the world. American Telephone boasts the widest distribution of any equity, here or anywhere else. I include the weekly charts of these two giant equities.

General Motors is well down from its high of over 100 last year. GM bounced off 66 in October of last year, then plodded into its current area in the 80's. The resistance above seems to be at about 88 for GM, with GM's 200-day moving average currently at 84. What this stock does in the period ahead may have an important bearing on the entire market. No single equity is watched with more interest than GM, and this might be particularly true now.



American Telephone has run into rough sledding, partly because it still continues to sell as a money-rate stock, and to some extent it competes in yield and bonds. A "head-and-shoulders" top was traced by T during 1966, and the rupturing of this formation took T to a 1967 low of 50½, slightly above the 49½ low of 1966 (which in turn was the lowest point for T since 1962.) A sharp rally (which I believe is abortive) took T back to 56 in a single week, but now the stock is sagging again. T is important because its price trend affects the assets of millions of investors, large and small throughout the nation.